

What Recapture Means to You



Some homebuyers, builders, real estate agents and mortgage lenders who want to use the California Housing Finance Agency's (CalHFA) low interest rate loans are concerned about the "Federal Recapture Tax." In reality, most borrowers may not have to pay any Recapture Tax. For others, the amount may be minimal.

We hope this information will remove needless worries and help more people benefit from CalHFA Mortgage Revenue Bond (MRB) programs.

Explaining the History

A federal law commonly known as Recapture Tax applies to borrowers who buy their home using MRBs like those issued by the California Housing Finance Agency.

Recapture Tax requires some borrowers to repay the federal government a portion of their gain upon the sale of the home if they financed their home with an MRB loan. This provision is administered by the Internal Revenue Service (IRS). If any Recapture Tax is due, the borrower pays it to the IRS after selling the home as part of their federal income tax liability for the year in which the home is sold. At the MRB loan closing, CalHFA provides a Recapture Disclosure form showing the maximum recapture tax which could be due, if any. This form is individualized for each borrower.

Removing the Mystery

The purpose of recapture is to focus the benefits of the MRB programs on families who need them most. Most borrowers will not have to pay Recapture Tax; however, for those who do, the tax will never exceed one-half of the gain on the sale of the home, or 6.25% of the original CalHFA mortgages, whichever is less.

This may sound complicated, but in many cases, little or no tax is due. For example:

- If your household income does not rise significantly over the life of the loan (generally more than 5% per year), there is no recapture.
- If you sell your home after nine years, there is no recapture.
- If you sell your home within nine years, but there is no gain, there is no recapture.
- In other words, to owe any recapture at all, you must sell your home within nine years, earn significantly more income than when you bought the home, and gain from the sale. All three of these criteria must be met.

The basis of recapture is this: borrowers will never pay more than 6.25% of the original loan amount, if they pay at all. Recapture taxes are figured on a scale based on the number of years the homebuyer has lived in the house, with the fifth year being the worst time to sell.

But That's Not the End of the Story

The tax guidelines are structured to help borrowers even if they do have to pay:

- The 5% increase in income that makes a borrower a candidate for recapture is figured from the maximum income limit for the MRB program at the time of purchase. For example, William earned \$40,000 per year when he purchased his home. At the time, the maximum income limit was \$62,500. The 5% increase would be figured from \$62,500, not \$40,000. William would actually have to receive in excess of a 5% increase in salary each year to be considered for recapture.
- Recapture Tax may not exceed 50% of the gain the borrower realizes upon the sale of the home. Even if William sold his home in year five, his income increased significantly, and he made \$2,000 on the sale, the maximum he could owe is \$1,000. And the gain is calculated after items such as the real estate agent's fee, legal fees, and closing costs.
- If the borrower's income exceeds the maximum income limit, but not by more than \$5,000, only a percentage of the tax must be paid.

For most people, the financial benefits of homeownership—deductions for mortgage interest and taxes as well as the MRB program's lower interest rates and down payment assistance—far outweigh the risk of recapture.

Additional Questions & Answers About Federal Recapture Tax

Can CalHFA tell me exactly what my Recapture Tax will be?

No. Because all Staff comments are subject to tax law interpretation, CalHFA's staff cannot assist you in determining the exact amount of the tax.

When do I pay the Recapture Tax?

Any Recapture Tax due is to be submitted with your individual tax return for the year in which you sold the property. For instance, if you sold the property in 2005, the Recapture Tax, if any, along with IRS Form 8828, must be submitted with your IRS Form 1040 in 2006. We strongly recommend that you obtain the services of a tax preparer for the tax year the Recapture Tax form is required to be submitted.

Does a refinance activate the Recapture Tax?

No, however, it does not eliminate the Recapture Tax either. If you refinance your loan and then sell your home within the first nine years of ownership, the potential for a Recapture Tax still exists. If you refinance during the first four years of ownership and then hold the property for more than 18 months, any potential Recapture Tax will be reduced.

Is it true I lose half of the gain on the sale of my house to Recapture?

Not usually. A gain is required for a Recapture Tax to be assessed; however, the amount of the gain can only cause the Recapture Tax to be reduced, never increased. The formula looks at 50% of the gain to see if it is less than the calculated Recapture Tax, and, if it is, you pay that lower amount.

What do I need to calculate my Recapture Tax?

You will need the closing statement from when you purchased the home, the closing statement from when you sold the home, the closing statement from the first of any refinances, and the Recapture Notice you would have received when the loan originally closed.

To help you find the Recapture Notice, you may wish to review the example on our web site. If you cannot locate your original Recapture Notice, e-mail us: homeownership@calhfa.ca.gov, and request a reconstructed letter. Recreated letters will usually be mailed within three business days.

How does the IRS track the amount of recapture tax due?

The borrower is required to file IRS Form 8828 with their federal income tax return for the year in which the home is sold or transferred.

What happens if my loan is assumed?

If the sale or transfer occurs within the first nine years of ownership, the original borrower pays the Recapture Tax due by them and a new nine-year period begins for the purpose of applying a new Recapture Tax to the assuming purchaser.

At the time of application, you will receive Recapture provisions and Disclosures with more detailed information. If you have additional questions, consult your tax professional or contact the California Housing Finance Agency at 877.9.CalHFA (877-922-5432)



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